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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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Federal Communications Commission
Office of Secretary

In the Matter of	)
	)
Petition for Forbearance From	)
the Current Pricing Rules for	)
the Unbundled Network Element	)
Platform	)

PETITION FOR EXPEDITED FORBEARANCE
OF THE VERIZON TELEPHONE COMPANIES

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SUMMARY

The Commission should forbear from its decision permitting UNE-P carriers to collect per-minute access charges from long distance carriers when it is the incumbent that actually provides the exchange access service, and, in addition, should forbear from applying its current TELRIC pricing rules to the so-called UNE platform.

The Commission has indicated that it intends to initiate a proceeding to reform its current TELRIC pricing rules. The Commission should do so expeditiously and move to a pricing standard based on the incumbent's actual forward-looking costs rather than the hypothetical network construct that underlies TELRIC. While the Commission completes this reform of its rules, it should immediately take the interim steps set forth in this petition to ameliorate the most harmful effects of those rules.

The Commission's current pricing rules for the UNE-Platform suffer from multiple flaws. First, the TELRIC rules themselves are inherently flawed. Because TELRIC assumes a hypothetical, ideally efficient network, it produces UNE rates that are lower than any real-world carrier can match. As a result, it fails to compensate incumbents fairly for the use of their networks and discourages investment by all carriers (incumbents and newer entrants alike). Second, the problems inherent in TELRIC are exacerbated by applying it to the so-called UNE platform. Applying TELRIC to the UNE platform creates a system of uneconomic arbitrage in which carriers obtain margins of 50 percent or more by merely reselling services over existing facilities without making any investments, while incumbents continue to bear the costs of maintaining and operating the network. In fact, UNE-platform carriers now openly tout the fact that under current rules they are able to reap large margins without the need for any infrastructure investment. And the arbitrage opportunity is so great it has even spawned a

cottage industry dedicated to helping carriers exploit the windfall arbitrage opportunities. Third, the problems are further compounded by the fiction embodied in current rules that UNE-P carriers are providing exchange access service and can collect the per-minute access charges from long distance carriers. In fact, it is the incumbent, as the underlying facilities provider, that is providing the exchange access service. The Commission's rule creates a loophole that lets UNE-P carriers skim off access charge revenues that were intended to support the ongoing operation and maintenance of the network infrastructure – not add to the profits of arbitrageurs investing little or nothing in the local network.

As actual market experience abundantly shows, the effect of the current pricing rules (along with the overly broad unbundling requirements) is three-fold. First, they have devalued the existing investments by incumbents and newer entrants alike in the nation's telecommunications infrastructure and are therefore profoundly deflationary. Indeed, the market capitalization of the telecommunications and equipment manufacturing sectors has declined by approximately $2 *trillion* since 2000. The rules effectively act as a tax on investment, allowing carriers with no facilities of their own to drain billions of dollars of revenue from the competing facilities-based providers (both incumbents and newer entrants) that deploy and maintain the nation's telecommunications infrastructure.

Second, the rules have contributed materially to the massive decline in investment in the telecommunications industry – a decline of roughly $60 billion in the wireline segment of the industry from 2000 to 2002 alone. Indeed, the TELRIC prices are so extreme that they even have caused competing carriers to curtail the use of their *existing* facilities in favor of UNE-P. Because of the importance of the telecommunications sector to the overall economy, this decline in investment has undermined growth of the national economy.

Third, the rules have precluded the development of a rational wholesale market because no carrier will negotiate to reach a market-based agreement when it can instead take advantage of below-cost TELRIC rates.

The Commission has ample discretion to take interim measures to immediately address some of the most harmful aspects of its pricing rules even while it completes its general reform of those rules. For example, as a small interim step toward remedying the larger arbitrage problem, the Commission could simply eliminate the fiction that a UNE-P carrier is providing the exchange access on long distance calls. This would recognize that the underlying facilities provider, as the entity that is actually providing those services, is entitled to the per-minute exchange access charges since the very purpose of those revenues is to support the operation and maintenance of the network infrastructure. Likewise, the Commission would be well within its authority to forbear from applying TELRIC to UNE-P and determine that, when a CLEC purchases a platform of all the elements necessary to provide service, the level of compensation to which the ILEC is entitled is no lower than it would receive under the Act's resale pricing standard.

Given all of this, the standard for forbearance set out in section 10 of the Act is unquestionably met. Forbearance will help to ameliorate the harmful effects of the current pricing rules, compensate incumbents more fairly, promote investment and the continued growth of facilities-based competition, and, in so doing, boost the overall economy. Thus, forbearance will advance consumer interests and is in the public interest.

Accordingly, the Commission should immediately move to grant this petition.

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PETITION FOR EXPEDITED FORBEARANCE OF THE VERIZON TELEPHONE COMPANIES[1]

The Commission should immediately forbear from its decision permitting UNE-P carriers to collect per-minute access charges from long distance carriers since it is the incumbent that actually provides exchange access service, and, in addition, should forbear from applying its current TELRIC pricing rules to the so-called UNE platform.

The Commission has indicated that it intends to initiate a proceeding to reform its current TELRIC pricing rules. The Commission should do so expeditiously and move to a pricing standard based on the incumbent's actual forward-looking costs rather than the hypothetical network construct that underlies TELRIC. While the Commission completes this reform of its rules, it should immediately take the interim steps set forth in this petition to ameliorate the most harmful effects of those rules.

I. THE CURRENT PRICING RULES THAT APPLY TO UNE-P ARE FLAWED IN MULTIPLE RESPECTS.

The Commission's current UNE pricing rules suffer from a number of flaws that discourage investment by all carriers, impede competition, and undermine economic growth.

1/ The Verizon telephone companies ("Verizon") are the affiliated local telephone companies of Verizon Communications Inc. These companies are listed in Attachment A.

As an initial matter, TELRIC itself is flawed. The core problem with TELRIC is that, rather than being grounded in the incumbent's existing network, it is based on regulators' conceptions of the hypothetically most efficient technologies and network configuration (with the sole exception of wire center locations). This hypothetical network construct creates two basic problems.

First, it results in UNE rates that are well below what the ILEC, or any other real-world carrier, could match. As a result, TELRIC discourages investment by all carriers. A competing carrier is less likely to incur the risks and costs of investing in its own facilities when it can obtain UNEs at rates based on the most efficient theoretical network imaginable and when any investment can be undercut by CLECs who benefit from below-cost UNE rates. And TELRIC discourages new investment by ILECs by requiring them to provide their network facilities to competitors at rates that will not permit ILECs to recover their investment.

Second, by basing rates on a hypothetical network, TELRIC functions as a "black box": it lacks any objective criteria or standards on which to base rates and accordingly provides considerable latitude to set rates without regard to costs. As a result, TELRIC has been applied, both in successive rounds of price setting proceedings and through this Commission's section 271 benchmarking standard, to ratchet down rates that previously were set in compliance with the TELRIC rules to lower levels based on ever more extreme assumptions. Since the beginning of 2002, for example, UNE-P rates have decreased by more than 30 percent in Arizona, Indiana, and California; by more than 20 percent in Idaho, Wisconsin, Utah, and Kentucky; and between

17 and 20 percent in Iowa, Georgia, Washington, Illinois, North Dakota, and Nebraska.[2/] This rapid reduction in UNE-P rates is not the result of some corresponding reduction in the *costs* of providing UNEs. Instead, this steady downward trend has been driven by pressure to produce the appearance of competition by providing CLECs what they claim is a "sufficient" profit margin between UNE prices and retail rates, which themselves are often artificially low, to make it worth their while to "compete" in a given state.

Independent analysts repeatedly have concluded that the result of all this is to produce artificially low rates that are well below any realistic measure of the incumbent's costs. For example, the May 1, 2002 quarterly report from Commerce Capital Markets provided a comprehensive analysis of UNE rates that have been established under the TELRIC pricing regime. The report concluded that "[f]or all RBOCs, UNEs are priced below cash operating cost, and radically below total operating cost including depreciation and amortization. The discounts from total cost are *50%-60%* below total cost even when total cost does not include cost of equity, a component that is allowed under TELRIC."[3/] Based on that analysis, the report concluded that " . . . regulators are forcing RBOCs to wholesale their network at rates that are significantly below the costs that the financial community looks at." *Id.*

The application of TELRIC to the UNE-P construct exacerbates its flaws. The artificially low UNE-P rates resulting from TELRIC allow carriers using UNE-P to resell services over existing facilities, not at the resale pricing standard prescribed by Congress, but at discounts of

2/ *See* The Negative Effect of Applying TELRIC Pricing to the UNE Platform on Facilities-Based Competition and Investment, at 1-13 (Attachment B hereto) ("*Report on Negative Effect of the UNE Platform*").

3/ A. Kovacs, et al. Commerce Capital Markets, Inc., *The Status of 271 and UNE-Platform in the Regional Bells' Territories* at 15 (May 1, 2002) (emphasis added).

50% or more without having any facilities of their own or adding anything unique of value. Moreover, the incumbent must still bear the full costs of operating and maintaining the network. The result, as a JP Morgan study concluded, is that "[w]hile the Bells lose roughly 60% of the revenues when they lose a line to a UNE-P based competitor, we estimate that they retain 95% of the costs."[4/] As a result, "UNE-P functions like a tax on investment, rather than a competitive incentive."[5/]

In addition, under the current rules, UNE-P carriers are able to earn substantial margins by selectively focusing on attractive urban and business customers. For example, a December 2002 Legg Mason study found that CLECs relying on UNE-P had average gross margins at the time ranging from *47% to 66%* in Massachusetts, Pennsylvania, Maine, Maryland, Delaware, Rhode Island, Vermont, Virginia, New Jersey, the District of Columbia, and New York.[6/]

The fiction embodied in the current rules that the UNE-P carrier provides exchange access service on the line only further compounds the problem. In reality, it is the ILEC as the underlying facilities provider that is actually providing the exchange access service and bearing the costs of doing so. And, of course, exchange access charges were designed to help pay for the cost of the underlying network infrastructure. Thus, the Commission's rule diverts access charge revenues that were designed to support the network infrastructure and simply adds to the uneconomic arbitrage opportunity available to UNE-P carriers. Indeed, one consultant emphasizes that a key "benefit with the UNE-P/CLEC arrangement" is the ability to collect

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4/ M. Crossman, *et. al*, J.P. Morgan Securities, Inc., *Industry Update – No Growth Expected for Bells in 2003* at 15 (July 12, 2002).

5/ *See* Scott Cleland, Precursor Group, "*Why UNE-P Is Going Away: Telecom's Changing Trajectory*" (Oct. 2, 2002).

6/ Legg Mason, *UNE-P Relief: Investors Expect Too Much* at 9 (Dec. 19, 2002).

access charges from long distance carriers and touts the fact that "UNE-P/CLEC'S can pay their ILEC bills [just with the access charges they receive] and keep all of the revenue they collect from their End Users."[7] The consultant's website goes so far as to provide a "calculator" to let carriers estimate how much they can collect through this access charge loophole.

II. THE CURRENT PRICING RULES FOR UNE-P ARE PROFOUNDLY UNECONOMIC, IMPEDE COMPETITION, AND HARM BOTH THE TELECOMMUNICATIONS INDUSTRY AND THE ECONOMY AS A WHOLE.

Actual market experience in the time since the current pricing rules were adopted demonstrates that those rules have produced UNE-P prices that fail to compensate the incumbents fairly for the use of their networks and that deter, rather than promote, investment in competing telephone networks and services. The effect of those rules has been three-fold.

First, the application of TELRIC rules to UNE-P has created a system of uneconomic arbitrage that has devalued existing investments by incumbents and newer entrants alike in the nation's telecommunications infrastructure and is inherently deflationary. As one analyst put it, "the macroeconomic consequences of the FCC's TELRIC fiat was to devalue three quarters of the Nation's telecom infrastructure by two-thirds."[8] Indeed, the market capitalization of the telecommunications and equipment manufacturing sectors has declined by some $2 *trillion* since 2000 alone.[9]

7/ *See* ISG Telecom, "Revenues for the UNE-P CLEC," *available at* http://www.isg-telecom.com/ (visited June 22, 2003).

8/ *Hearings before the Subcomm. On Telecommunications Trade & Consumer Protection of the House Commerce Comm.*, 106th Cong. 2 (May 25, 2000) (Written statement of Scott Cleland, Managing Director, The Precursor Group) ("Cleland Statement").

9/ *See*, *e.g.*, S. Rosenbush, *et al.*, "Inside the Telecom Game: How a Small Group of Insiders Made Billions as the Industry Collapsed," *Business Week* 34 (Aug. 5, 2002) ("Investors have lost some $2 trillion [in telecom] as stock prices have tumbled 95% or more from their highs."); P. Starr, "The Great Telecom Implosion," *The American Prospect* 2024 (Sept. 9, 2002)

The rules have created this result by allowing carriers with no facilities of their own to drain literally billions of dollars of revenues away from the competing providers that deploy and maintain that infrastructure. The TELRIC rules devalue the investments of incumbent carriers by prescribing rates for those facilities that substantially understate any real-world measure of their costs. And they devalue investments by competing facilities-based providers because CLECs that take advantage of the arbitrage opportunity created by TELRIC, particularly when applied to UNE-P, can undercut those investments. Thus, as one analyst has concisely explained, the "consequences of the FCC's strategy has been to effectively devalue all infrastructure investment by everyone, incumbents and competitors alike." *See* Cleland Statement at 2.

Second, the application of TELRIC to UNE-P has unquestionably contributed to a massive decline in telecommunications industry investment, directly contravening the core goal of the 1996 Act. Because of the importance of the telecommunications sector to the overall economy, it also has hampered economic growth.

As independent analysts at McKinsey & Co. and JP Morgan have explained, the incentives created by TELRIC are clear: "[n]o company will deploy and scale facilities if it can achieve similar economics immediately by renting network elements from the ILECs – all with little up-front investment."[10/] Similarly, as Scott Cleland of the Legg Mason Precursor Group put it, "why overbuild if one can lease it more cheaply than one can build it? We strongly

("Out of the $7 trillion decline in the stock market since its peak, about $2 trillion have disappeared in the capitalization of telecom companies.").

[10/] McKinsey & Co. and JP Morgan H&Q, *Broadband 2001, A Comprehensive Analysis of Demand, Supply, Economics, and Industry Dynamics in the U.S. Broadband Market* at 18 (Apr. 2, 2001).

suspect that the success of the UNE-P resale will adversely affect the incentive for facilities-based competition."[11/] Other analysts have likewise concluded that "[s]ix years following the Act, we are left with virtually no structural incentive for any company to ever build an alternative local network that will compete with local carriers over time"[12/] and that "under a more rational local competitive framework, overbuilding might have occurred to a greater extent."[13/]

The numbers bear this out. According to one recent report, between 2000 and 2002, as previously prescribed TELRIC rates were further slashed, overall investment by wireline telecommunications carriers declined from $104.8 billion to $42.8 billion – a decline of more than $60 billion in just two years.[14/] This downward trend applies to incumbents and competing carriers alike. For example, one analyst estimates that total capital expenditures by the Bell companies combined declined by approximately 35 percent from 2001 to 2002 alone.[15/] Meanwhile, capital expenditures by facilities-based CLECs reportedly declined by 19 percent from 2000 to 2001, and by 56 percent from 2001 to 2002.[16/] And the *Wall Street Journal*

11/ Cleland Statement at 2; *see also* S. Cleland, Precursor Group, *Why UNE-P Is Going Away: Telecom Competition's Changing Trajectory* (Oct. 2, 2002).

12/ Gregory P. Miller, *et al.,* Fulcrum Global Partners, *Wireline Communications: Thoughts on FCC Order* at 2 (Feb. 25, 2003).

13/ B. Roberts, *et al.*, Dresdner Kleinwort Wasserstein, *UNE-P: The Unprofitable RBOC* at 3 (Aug. 9, 2002).

14/ Skyline Marketing Group, *CapEx Report: 2002 Annual Report*, Carrier Data Sheet 1 (June 2003).

15/ UBS Warburg, *Are the Bells Growing Less Profitable?* at 41 (April 16, 2003).

16/ Association for Local Telecommunications Services, *The State of Local Competition 2003* at 10 (Apr. 2003).

recently reported that "spending on equipment by the six major telecom operators that have reported was down an average of 19% in the first quarter [of 2003] compared with the same period the year before, widely considered to be the worst year in the telecom industry's history."[17]

In fact, many ostensible competitors state that under the current rules they have no intention of *ever* deploying their own facilities. One CLEC, for example, has told investors that its "UNE-P-based business model allows us to avoid significant capital investments in network facilities."[18] Similarly, other CLECs have assured the markets that they "can now lease the necessary elements of the Bell network – without the need for costly network infrastructure, which allows us to earn attractive gross margins" and that they are "deploying very little capital" to provide UNE-P service.[19]

The arbitrage opportunity is so great it even has spawned the creation of a cottage industry dedicated to helping companies "become a UNE-P CLEC" in order to take advantage of the "50% to 70% Net Profit Available" in an environment where "[n]o equipment investment is required!"[20] One consultant informs potential UNE-P carriers that "no switching equipment is

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17/ A. Latour, *et al.*, *A Wrong Number for Telecom: Big Operators Cut Spending 19%*, Wall St. J. (Apr. 28, 2003).

18/ *See* Z-Tel, 2001 Annual Report at ii ("Z-Tel was formed around UNE-P.").

19/ Talk America, 2001 Annual Report at 7; Wayne Huyard, Chief Operating Officer, MCI, *Using UNE-P To Develop a Strong and Profitable Local Presence*, Goldman-Sachs Telecom Issues Conference, New York, NY (May 7, 2002); *see also* Talk America, Form 10-K/A at 6 (SEC filed Apr. 12, 2002) (Talk America "believes that UNE-P currently provides it with a cost-effective means of adding local service to its existing long distance product offerings.").

20/ *See* American Discount Telecom, "50% to 70% Net Profit Available to Competitive Telephone Companies," *available at* http://a-adt.com (visited June 5, 2003); *see also* "The U S Supreme Court Wants CLEC's To Make More Money With UNE-P! You Don't Need Resale Anymore!," *available at* http://a-adt.com/une-p-clec.html (visited June 5, 2003).

required, but instead you lease ports on the ILEC's switches for a fraction of the cost of purchasing equipment," which produces "profit margins" that "range from 50-90%."[21]

In addition to declining investment in new facilities, the current TELRIC rules also have caused CLECs to curtail the use of their *existing* facilities in favor of the UNE platform at artificially low TELRIC rates. For example, in just eight states where carriers now make extensive use of UNE-P, competing carriers connected more than *600,000 fewer lines* to their own switches using unbundled loops in 2002 than they did in 2000.[22] During the same period of time, competing carriers nationwide added more than 9 million UNE-P lines – an increase of approximately 2000 percent. *Id.* at 16. Independent analysts have observed the same trend.[23]

Moreover, competing carriers not only are adding substantially fewer *new* lines to their existing facilities, but have begun to move *existing* customers that they were serving using their own facilities to UNE platform arrangements. For example, evidence filed with the Commission in its *Triennial Review* proceeding demonstrated that a number of carriers had begun to transfer lines off their own switches and onto UNE-P arrangements.[24] This trend is consistent with the

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21/ ISG Telecom, *Revenues for the UNE-P CLEC, available at* http://www.isg-telecom.com.

22/ *Report on Negative Effect of UNE-P* at 15-16. The eight states are New York, New Jersey, Massachusetts, Georgia, Florida, Illinois, California and Texas.

23/ *See, e.g.*, R.E. Talbot, RBC Capital Markets, Investext Rpt. No. 7229059, *Integrated Telecommunication Services – Moderating Expectations for Triennial Review – Industry Report* at *13 (Feb. 18, 2003) ("Competitor UNE Lines with CLEC switching declined to 35% (or 4.1 million) of total UNE switched lines. This compares to 39% (3.7 million) in the preceding six months and 67% as at December 1999. We expect this trend to continue as CLECs pursue UNE-P based strategies in additional markets.").

24/ *See, e.g.*, UNE Rebuttal Report 2002 at 31, n.161, *Review of the Section 251 Unbundling Obligation of Incumbent Local Exchange Carriers*, CC Docket Nos. 01-338, *et al.* (FCC filed Oct. 23, 2002); Letter from William Barr, Verizon, to Michael Powell, FCC, at 17-18, *attached to* Ex Parte Letter from Ann Berkowitz, Verizon, to Marlene Dortch, FCC, CC Docket No. 01-338 (Oct. 16, 2002).

Commission's own data, which shows that the number of CLEC-owned lines other than those provided through cable *decreased* by 700,000 lines between December 2000 and December 2002, while the number of UNE-P lines increased from 2.8 to 10.2 million. *Report on Negative Effect of the UNE Platform* at 20.

CLECs also have expanded the use of UNE-P to classes of customers that previously were served predominantly using some or all of the CLECs' own facilities. This trend is evident in the business market, which has previously been a particularly attractive market for competing carriers to deploy their own facilities. For example, the percentage of competing carriers' business lines served by UNE-P in Verizon's region more than doubled (from 6 percent to 13 percent) from the end of 2001 to February 2003. *Report on Negative Effect of the UNE Platform* at 17. Other examples abound.

The reason for this trend is succinctly stated: TELRIC not only deters carriers from investing in the first place, it also harms those competing carriers that have chosen to pursue a facilities-based strategy because such carriers find themselves competing against below-cost UNEs. Facilities-based carrier Allegiance Telecom, for example, has indicated that low UNE-P prices "mak[e] it more difficult for efficient facilities-based [competitive local exchange carriers] to compete."[25/] Independent analysts too have recognized that TELRIC's artificially low prices harm facilities-based carriers. Credit Suisse First Boston noted that it "turned pessimistic about the extent to which Cox Communications will generate money from offering local telephone service over its cable TV systems" because "the long distance carriers' use of UNE-P has picked

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[25/] *See* Letter from Kevin M. Joseph, Vice President Government Affairs, Allegiance Telecom, Inc., to the Magalie Salas, FCC, CC Docket No. 96-98, Attachment at 2 (Feb. 2, 2001).

up speed of late."[26] Similarly, Legg Mason, commenting on WorldCom's plan to expand its UNE-P offerings, wrote: "the more successful the plan is, the more it will reduce the attractiveness of the telephony opportunity for cable."[27]

Third, the TELRIC rules have precluded the development of a rational wholesale market. Incumbents have every incentive to recover their costs by filling their networks with revenue-producing traffic. While an incumbent would generally prefer to have the end user as its customer and collect the resulting retail revenues, it clearly would rather collect the revenue generated by having the wholesale traffic on its network than forfeit this revenue entirely because that traffic ended up on alternative facilities, such as cable and wireless networks. This is particularly true because incumbents already are losing millions of lines and billions of minutes to facilities-based competitors, including cable telephony providers, wireless carriers, and less traditional sources of competition such as voice over IP, e-mail, and instant messaging. *See generally Report on Negative Effect of the UNE Platform* at 20-29. Thus, incumbents have strong reasons to enter into rational, voluntary wholesale arrangements at compensatory rates.

Incumbents find themselves in a similar position to AT&T when the long distance market was opened to competition. In that case, as here, AT&T had market incentives to offer competitive but rational terms to wholesale customers to keep as much long distance traffic as possible on its network rather than having traffic migrate to competing facilities. As a result, a wholesale market developed in which carriers purchased capacity from AT&T at compensatory

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26/ George Mannes, *Cox's Prospects for Growth May Be Fading*, The Street.com (Sept. 19, 2002), *available at* htttp://www.thestreet.com/tech/georgemannes/10043045.html (citing Credit Suisse First Boston analyst Lara Warner).

27/ B. Levin, *et al.*, Legg Mason Wood Walker, *WorldCom/MCI Bundled Phone Offer Challenges Rivals, Regulators* at 2 (Apr. 23, 2002).

rates and resold that capacity to end users. TELRIC, particularly when applied to UNE-P, has precluded the development of a similarly rational wholesale market for local telecommunications by setting rates that are well below the costs of any real-world carrier.

III. THE COMMISSION HAS AMPLE AUTHORITY TO TAKE INTERIM STEPS TO LIMIT THE HARMFUL EFFECTS OF APPLYING THE CURRENT PRICING RULES TO UNE-P.

The Commission has ample authority to adopt interim measures to ameliorate the most harmful aspects of the current pricing rules while it completes its proceeding to reform those rules more generally.

As an initial matter, the relevant provisions of the Act do not, as the Commission has recognized, require the current TELRIC pricing rules. Rather, section 252(d)(1) specifies only that UNE prices are to be based on "the cost . . . of providing . . . the network element," plus a "reasonable profit." The generality of those terms led the Supreme Court to conclude that the statute "leaves [pricing] methodology largely subject to the Commission's discretion."[28/] Likewise, the Commission has recognized that nothing in the Act or elsewhere requires that prices be based on "a particular variant of forward-looking economic cost, such as TELRIC."[29/]

28/ *See Verizon Communications v. FCC*, 535 U.S. 467, 499-500 (2002) ("[T]he Act uses 'cost' as an intermediate term in the calculation of 'just and reasonable rates,'" and "regulatory bodies required to set rates expressed in these terms have ample discretion to choose methodology.") (internal citations omitted); *id.* at 500 ("[W]ords like 'cost' 'give rate setting commissions broad methodological leeway; they say little about the 'method employed' to determine a particular rate.'").

29/ *See, e.g.*, Memorandum Opinion and Order, *AT&T Corporation v. Bell Atlantic Corporation, et al.*, 15 FCC Rcd 17066, 17069 ¶ 9 n.16 (2000) ("In citing past examples of approaches to forward-looking cost, we did not somehow confine the term 'forward-looking economic cost' to those examples, nor did we convert the requirement in the text of the *Merger Order* – that Bell Atlantic employ forward-looking costs as a general matter – into a more rigorous requirement that Bell Atlantic employ a particular variant of forward-looking economic cost, such as TELRIC.").

As discussed above, it is now clear that applying TELRIC to UNE-P arrangements does not come close to permitting incumbents to cover any real-world measure of their costs of providing UNEs, forward-looking or otherwise, let alone earn a reasonable profit.

Similarly, nothing in the Act says a word about the UNE-P. Rather, the UNE-P is a regulatory construct devised by the Commission. As Chairman Powell has explained, UNE-P "wasn't in the statute. It was sort of a creative combination of the Commission."[30] The Act obligates an incumbent only to lease to competitors individual pieces of its network that satisfy the necessary and impair standards of section 251(d)(2) or to provide wholesale services for resale by competitors at a discount based on the incumbent's "avoided costs." The Commission determined, however, that incumbents also must provide access on an "unbundled" basis to a fully bundled "platform" of facilities necessary to provide precisely the service that the incumbent already provides. This is beyond the requirements of sections 251 and 252 themselves. Although the Supreme Court upheld the Commission's discretion to embrace this "all elements" fiction under the Act, *Iowa Utils. Bd. v. FCC*, 525 U.S. 366, 392-93 (1999), it said nothing to foreclose a different result based on actual market experience in the time since then.

In any event, to the extent that the Commission had discretion to create the UNE-P, it also has discretion to define the pricing rules that apply. In particular, the Commission would be well within its interpretive authority to hold that, when a CLEC wishes to purchase a platform of all the network elements necessary to provide an existing service, the compensation to the

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[30] "Powell Defends Stance on Telecom Competition," *Communications Daily* (May 22, 2001); *see also Competition Issues in the Telecommunications Industry*, Hearings before the Senate Comm. on Commerce, Science, and Transportation, 108th Cong. (2003) (Written statement of Michael K. Powell, Chairman, FCC) ("UNE-P is not a network element, nor does the statute provide for it as a complete entry vehicle. UNE-P is a consequence of previous regulatory decisions . . . .").

incumbent should be no lower than under the resale pricing standard prescribed by Congress (or at alternative rates a CLEC negotiates with the ILEC). *See* 47 U.S.C. §§ 251(c)(4), 252(d)(3). Such an approach would have immediate and beneficial effects by ending the most pernicious form of uneconomic arbitrage and the disincentives it creates for investment by incumbents and entrants alike. At the same time, as Congress itself determined by including the resale provision within the Act, it would provide a means for CLECs to enter the market and establish a customer base while they deploy at least some of their own facilities.

Likewise, the Commission has ample authority simply to eliminate the fiction that a UNE-P carrier provides exchange access services to originate and terminate long distance traffic on a UNE-P line, and forbear from its current rule that UNE-P carriers are entitled to collect per-minute access charges from IXCs for the provision of exchange access service.[31/] In reality, a CLEC that purchases UNE-P simply acts as a marketer of local services provided using the incumbent's facilities. It is the incumbent that continues to provide exchange access for the origination, termination, and transport of long distance calls. Indeed, in the case of exchange access service, a UNE-P carrier does not even engage in the retail marketing functions that it does in connection with local service. And because exchange access charges were designed as a way to help pay for the underlying network infrastructure, determining that the incumbent, as the underlying facilities provider, is entitled to the per-minute access charges would ensure that the

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[31/] First Report and Order, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 11 FCC Rcd 15499 ¶¶ 358-65 (1996) ("*Local Competition Order*").

underlying network provider receives the payments that were intended to support the ongoing operation and maintenance of that network.[32]

Moreover, such an approach also is consistent with the expressed intent of Congress that the 1996 Act should not disrupt the pre-existing access charge regime that helped pay for the local network. Section 251(g) of the Act expressly provides that LECs "shall provide exchange access . . . in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (*including receipt of compensation*) that apply to such carrier" prior to the Act. 47 U.S.C. § 251(g) (emphasis added). As the Commission has stated in describing the effect of section 251(g), "[b]efore Congress enacted the 1996 Act, LECs provided access services to IXCs and to information service providers in order to connect calls that travel to points - both interstate and intrastate - beyond the local exchange. In turn, both the Commission and the states had in place access regimes applicable to this traffic, which they have continued to modify over time. It makes sense that Congress did not intend to disrupt these pre-existing relationships."[33] Thus, the Commission may properly condition the continued availability of UNE-P at TELRIC rates on the payment by long distance carriers of per-minute access charges to the incumbent.

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[32] *See, e.g.*, First Report and Order, *In the Matter of Access Charge Reform*, 12 FCC Rcd 15982 ¶¶ 17, 21 (1997) (noting that "[t]he access charge rules provide for the recovery of the incumbent LECs' costs assigned to the interstate jurisdiction" for "the costs of th[e] common plant" that is "needed to originate and terminate interstate long-distance calls").

[33] Order on Remand and Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996: Intercarrier Compensation for ISP-Bound Traffic*, 16 FCC Rcd 9151, 9168 ¶ 37 (2001). Although the D.C. Circuit subsequently criticized the Commission's reliance on section 251(g) in this order, it did so on the ground that "there had been *no* pre-Act obligation relating to intercarrier compensation for ISP-bound traffic." *WorldCom, Inc. v. FCC*, 288 F.3d 429, 433 (D.C. Cir. 2002). That reasoning obviously is inapplicable to access charges for exchange access service, for which there clearly were rules and obligations in place prior to the Act.

Although the Commission previously concluded that incumbents should not receive exchange access charges when they provide network elements, it is free to forbear from that conclusion as it applies to the UNE-P for several reasons. First, the Commission previously reached this conclusion based primarily on the theory that TELRIC rates "represent[] full compensation to the incumbent LEC for use of the network elements that carriers purchase" and that permitting recovery of access charges accordingly would "constitute double recovery."[34/] As described above, marketplace experience since the Commission's decision has demonstrated that UNE-P rates clearly do not provide incumbents recovery of any real-world measure of their costs. In any event, there would be no double recovery even if TELRIC were not flawed. The incumbent would collect only one usage-based charge for each call: it would receive only per-minute access charges from long distance carriers for long distance calls, and it would receive only per-minute UNE charges (e.g., switching and shared transport charges) from CLECs for local calls.

Second, the Commission has not explicitly considered whether its access charge conclusion should apply in the case of the UNE platform, an issue that raises unique interpretive questions concerning the applicability of the resale and UNE pricing standards to a regulatory construct that is as a practical matter largely identical to a resale arrangement. Because the UNE platform is nothing more than a regulatory fiction that allows a CLEC to pay TELRIC rates rather than the wholesale rates prescribed by statute for what amounts to a resale arrangement, the Commission may reasonably conclude that the fiction should not extend so far as to deprive the incumbent of the access charges it would receive under a standard resale arrangement.

34/ First Report and Order, *In the Matter of Access Charge Reform*, 12 FCC Rcd 15982 ¶ 337 (1997); *see also Local Competition Order* ¶ 363.

Third, because neither the UNE platform nor the TELRIC methodology is sacrosanct, to the extent that UNE-P continues to be available at TELRIC rates while the Commission completes its proceeding to reform its pricing rules generally, it is well within the scope of the Commission's power to condition that discretionary availability on the incumbent's receiving payment of per-minute access charges for any interstate traffic originated or terminated on the line at issue.[35/] The Commission, of course, routinely conditions the availability or approval of a particular benefit on the fulfillment of particular conditions.[36/]

Fourth, as the Commission itself concluded in the *Local Competition Order*, nothing in the statute precludes it from determining, at least on an interim basis until it reforms its TELRIC rules, that in order to promote an important statutory goal, the incumbent should collect per-minute access charges for the origination or termination of interstate traffic.[37/] Though the

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35/ *See, e.g.*, *United States v. Chesapeake & Ohio R.R.*, 426 U.S. 500, 514-15 (1976) (upholding as "a legitimate, reasonable, and direct adjunct to the Commission's explicit statutory [suspension] power" the ICC's authority agency to withhold suspension of a tariff that would increase railroad rates subject to the condition that the railroad use the resulting proceeds for capital improvements and deferred maintenance); *Trans Alaska Pipeline Rate Cases*, 436 U.S. 631, 655-56 (1978) (upholding ICC order suspending oil pipeline's initial rate tariff but permitting pipeline to file revised tariff, at specified interim rates, to take effect on one-day's notice, subject to the condition that the pipeline agree to refund the difference between any amounts collected during and after the suspension period and the amounts ultimately held to be reasonable).

36/ *See, e.g.*, Seventh Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform*, 16 FCC Rcd 9923 ¶¶ 3-4 (2001) (conditioning the ability of CLECs to continue temporarily to charge above-market rates for terminating access in exchange for a mechanism under which those rates would be required to benchmark to ILEC rates over time); Order on Remand and Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, 16 FCC Rcd 9151 ¶ 89 (2001) (conditioning the ability of ILECs to take advantage of the new intercarrier compensation regime on their willingness to offer "to exchange all traffic subject to section 251(b)(5) at the same rate").

37/ *See Local Competition Order* ¶¶ 726-27. The Commission's decision on this score was upheld by the Eighth Circuit in *Competitive Telecommunications Ass'n v. FCC,* 117 F.3d 1068 reasons justifying forbearance here differ somewhat from those on which the Commission relied for its decision in the *Local Competition Order,* the need here is no less compelling. Indeed, in that case, the Commission was concerned that entry and investment decisions "would be driven by regulatory distortions . . . rather than the unfettered operation of a competitive market." *Local Competition Order* ¶ 719. Likewise, the application of below-cost TELRIC rates to UNE-P, combined with CLECs' ability to collect per-minute access charges from IXCs, has led to massive regulatory arbitrage that is distorting carriers' investment and entry decisions.

In sum, the Commission has ample discretion to forbear from applying TELRIC to UNE-P or, alternatively, to permit UNE-P carriers, rather than incumbents, to collect per-minute access charge revenue.

IV. THE STANDARDS FOR FORBEARANCE ARE UNQUESTIONABLY SATISFIED.

Section 10 of the Act provides that the Commission "shall" forbear from applying any regulation or any provision of the Act to telecommunications carriers if the Commission determines that the three conditions set forth in Section 10 are satisfied. All of Section 10's conditions are met here. Indeed, given the flaws inherent in the current pricing rules for UNE-P

(8th Cir. 1997). Of course, the only issue in that case was whether the Commission's decision to require payment of certain access charges to incumbents on an interim basis was reasonable, and the court's only holding was that the decision was reasonable. To the extent dicta in that decision might be read to suggest that the Act required those charges to be phased out under the circumstances at issue there, that obviously does not tie the Commission's hands here. On the contrary, neither the Commission's nor the court's decision reflected any consideration of the unique circumstances presented by a CLEC's use of the UNE platform at TELRIC prices, nor did it take account of the Commission's power to condition the availability of the UNE platform at those prices on the payment of such access charges. Moreover, here the Commission would not be requiring CLECs to *pay* access charges in addition to UNE rates as it did in the *Local Competition Order*; rather, it would simply be forbearing from its decision allowing them to collect that revenue from long distance carriers in the first place based on a recognition that a UNE-P carrier does not provide exchange access service.

and the negative effect they have on the development of facilities-based competition, the public interest requires that the Commission move expeditiously to remedy the most harmful aspects of those pricing rules.[38/]

A. The Current Pricing Rules for UNE-P Are Not Necessary To Ensure That Charges, Practices, Classifications, or Regulations Are Just and Reasonable and Are Not Unjustly or Unreasonably Discriminatory.

With respect to the first prong of the section 10 analysis, and as the foregoing discussion amply demonstrates, the current pricing rules for UNE-P are not necessary to ensure just, reasonable, and nondiscriminatory rates. This is true for several reasons.

First, as discussed above, the current pricing rules produce rates that are well below any rational measure of the costs of providing the UNE-P and accordingly – far from being "necessary" to ensure just and reasonable rates – actually result in unjust and unreasonable rates. Such rates are unjust because they do not compensate ILECs for even the actual forward-looking costs that incumbents incur on behalf of the CLECs that purchase the UNE-P. And they are unreasonable because they discourage investment by all carriers and thereby undermine one of the core goals of the 1996 Act.

Second, the current pricing rules for UNE-P are not necessary to ensure just and reasonable rates because there are better alternatives. Ultimately, of course, the Commission can and should revise its pricing rules so that UNE rates are set based on the incumbent's actual forward-looking costs. But even prior to completing that general reform, as described above, the

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38/ Because, as discussed above, neither TELRIC nor UNE-P is required by the Act, Section 10(d) of the Act in no way limits the Commission's ability to forbear from applying its current pricing rules for UNE-P. That section only precludes the Commission from forbearing "from applying the *requirements* of section 251(c) or 271 . . . until it determines that those requirements have been fully implemented." 47 U.S.C. § 160(d) (emphasis added). In addition, once a carrier receives long distance authority in a given state, the Commission itself has concluded that those requirements have been fully implemented. *See* 47 U.S.C. § 271(d)(3)(A)(i).

Commission can forbear from applying the portion of the current regime that entitles UNE-P carriers to collect per-minute access charges from long distance carriers. Similarly, the Commission can forbear from applying TELRIC to UNE-P and say that incumbents should receive compensation for UNE-P that is no less than provided under the resale standard, thereby restoring the balance that Congress originally struck.

Finally, the current pricing rules for UNE-P are unnecessary to ensure nondiscriminatory rates. First, they are not necessary to protect against discrimination among CLECs because, to the extent that the Commission determined that the resale pricing standard should govern in place of TELRIC in the case of UNE-P, the same rates would apply to all CLECs. Likewise, forbearance from the Commission's decision allowing CLECs to collect access charges would not differentiate among CLECs. Nor is there any plausible argument that the current pricing rules are somehow necessary to protect against discrimination between CLECs and incumbents themselves. To the contrary, those rules discriminate against *incumbents* by providing CLECs access to network facilities at rates below the costs that the incumbent itself must bear when it uses those facilities. Accordingly, forbearance is required to eliminate this disparity and put incumbents and CLECs on the same footing.

B. The Current Pricing Rules Are Not Necessary for the Protection of Consumers.

Similarly, with respect to the second prong of section 10, applying the current pricing rules to UNE-P is not necessary to protect consumers. On the contrary, forbearance will affirmatively further consumer interests by encouraging the development of facilities-based competition and by promoting the kind of innovation and meaningful consumer choice that only real, as opposed to merely "synthetic," competition can produce. Thus, applying the current pricing rules lacks "a strong connection" to, and is not "required to achieve[,] the desired goal of consumer protection." *CTIA v. FCC*, No. 02-1264, slip op. at 17 (D.C. Cir. June 6, 2003).

As demonstrated above, the current pricing rules have dampened investment and innovation by incumbents and competitors alike and encouraged CLECs to rely on UNE-P even in cases where they could provide service more efficiently using at least some of their own facilities. The result has been fewer genuine choices for consumers than would otherwise exist. While carriers using UNE-P can "compete" with incumbents in terms of marketing and other retailing functions, because they rely on the same underlying network facilities as the incumbent, their ability to innovate and offer new services or functionalities is limited. As Justice Breyer observed, "[i]t is in the *un*shared, not in the shared, portions of the enterprise that meaningful competition would likely emerge."[39] Thus, forbearing will remove the disincentives for efficient investment and affirmatively promote consumer interests by triggering the virtuous cycle of investment and innovation that only real facilities-based competition can produce.

There also is no basis for any claims that applying the current pricing rules to UNE-P is necessary to prevent consumers from being harmed. On the contrary, while forbearance may mean that CLECs have smaller profit margins than they currently do for services that they provide using UNE-P at artificially low TELRIC rates, they will be in no different position than incumbents. Like the incumbents and other competitors, CLECs using UNE-P will have to make business decisions about how best to recover their costs over their full range of services and customers. While some individual customers or services may not be profitable because of uneconomic retail price regulations, that same problem confronts the incumbents. It merely

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[39] *Iowa Utils. Bd.* 525 U.S. at 429 (Breyer, J., concurring in part and dissenting in part).

means that, like incumbents, CLECs will have to serve a range of customers and provide a variety of services in order to recoup their costs.

Indeed, one of the clear trends that has emerged as a result of competition from alternative delivery platforms is for service providers to offer a wide array of bundled service options that provide consumers numerous services at a single attractive price. This trend began with new pricing plans introduced by wireless providers that included flat rated bundles of minutes (including any distance minutes), packaged together with additional services such as voice mail and caller ID. Likewise, today cable companies offer their own package deals. For example, Cox Communications offers the Cox Value Bundle, where a customer can "save up to $238" by subscribing to "all three services – Standard Cable, High Speed Internet, and Digital Telephone."[40/] Similarly, facilities-based competing carriers also offer bundled services. For example, RCN reports that its RCN Essentials package allows the customer to "build [their] own bundle [by combining] Cable TV, unlimited local Phone Service, and High-Speed Internet."[41/] In the face of competition from these competing facilities platforms, incumbents have rolled out innovative packages of their own. For example, Verizon's "Veriations All" plan allows customers to "save as much as a third off the regular price of individual services" with annual savings of "$250 a year for the long distance, wireless and DSL components" and "$800 per year when local services are included."[42/]

40/ Cox Communications, *Hampton Roads, VA, Bundle Savings*, *available at* http://www.cox.com/hamptonroads/bundle.asp.

41/ RCN, *Essentials*, *available at* http://www.rcn.com/essentials/index.php.

42/ Verizon Press Release, *Verizon Revolutionizes Communications Service for Consumers With one Package, One Call, One Bill for Local, Long-Distance, DSL and Wireless* at 2 (Aug. 6, 2002).

Consequently, consumers already have begun to see the benefits of real competition from multiple facilities-based platforms. By restoring incentives for further investment in alternative facilities and technologies, forbearance from applying the current pricing rules to UNE-P will only accelerate this trend.

C. Forbearance Is Consistent with the Public Interest.

Finally, with respect to the third prong of the analysis, forbearance is in the public interest.

As explained in detail above, the current pricing rules have contributed materially to a massive decline in telecommunications investment.[43/] Forbearance will restore rational investment incentives and help to turn this disturbing tide, while also promoting "competition among providers of telecommunications services." 47 U.S.C. § 160(b). The benefits of added investment will flow not just to the telecommunications sector itself, but also to the ailing equipment manufacturers and high-tech sectors. Indeed, because of the importance of the telecommunications industry to the overall economy, forbearance can contribute to economic growth and the country's international economic competitiveness.

In addition, by encouraging carriers to deploy redundant network facilities that could become critical in the event of a terrorist attack or some other calamity that might befall the incumbent carriers' networks, forbearance also will contribute to national security. As Chairman Powell has noted, "[o]nly through facilities-based competition can our Nation attain greater

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43/ Robert E. Litan, *The Telecommunications Crash: What To Do Now?*, Brookings Policy Brief #112 (Dec. 2002); S. Rosenbush, et al., *When Will the Telecom Depression End?,* Business Week (Oct. 7, 2002).

network redundancies for security purposes and national emergencies."[44/] Commissioner Martin also has acknowledged the importance of redundant network facilities to national security stating "as we saw on September 11, there are network reliability and security advantages to having multiple facilities-based competitors."[45/] In light of all these considerations, forbearance unquestionably will promote the public interest.

44/ Michael K. Powell, Chairman, FCC, Remarks Before the Goldman Sachs Communicopia XI Conference, New York, N.Y. at 6 (Oct. 2, 2002).

45/ Kevin J. Martin, Commissioner, Federal Communications Commission, *Framework For Broadband Deployment*, Remarks Before the National Summit On Broadband Deployment (Oct. 26, 2001).

CONCLUSION

For the foregoing reasons, the Commission should forbear from applying its current pricing rules to the UNE-P.

Respectfully submitted,

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